TAX FORUM

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The Multistate Tax Compact

Recent developments in the field of state taxation indicate that a brief review of the present situation is imperative. Public Law 86-272, the stop-gap legislation enacted in 1959, was designed to restrict state taxation of interstate commerce, pending an in-depth study of the problem. Essentially that law exempted out-of-state corporations from state taxation where selling activity was confined to the solicitation of orders. During the past six years the Federal Government has conducted hearings, where state tax administrators and representatives of taxpayers have participated, in connection with their study of the burden of state taxation as it affects the flow of commerce. The first statutory attempt to alleviate the problem in 1966 was met with strong opposition; and in January of this year a compromise was attempted with the introduction of H.R. 2158 by the Special Subcommittee on State Taxation of Interstate Commerce. While this bill is important, of even more importance is the alternative legislation that has been triggered at the state level, and it is with the latter that we should be most concerned.

The Council of State Governments drafted the "Multistate Tax Compact" with the aid of the National Association of Tax Administrators, the National Association of Attorneys General and the National Legislative Conference. The Compact is designed to deal with the current tax problems of a multistate business, as well as to provide the means of coping with future problems, through the organization of a Multistate Tax Commission. The threat of Federal invasion of state and local taxing power coupled with the desire to promote uniformity in state taxation has been responsible for the prompt adoption of this Compact by eleven states in the first six months after its promulgation. Bills concerning its adoption are also pending in five other states.

Basically the Compact deals with income, capital stock, gross receipts and sales and use taxes at the state and local level. Space will not permit analyzing the full text of the Compact, but there is one facet that demands our attention—namely, the Uniform Division of Income for Tax Purposes Act. This phase will be utilized by taxing authorities adopting the Compact and also by states that have adopted *only* this portion, as for example, California. It would seem that within the year nearly half of the states will have adopted this act on a permissive or a mandatory basis.

Under the Multistate Tax Compact, in instances where the taxpayer is subject to an income tax and apportionment of income in arriving at such tax, he may allocate in accordance with state law; or, *at his option,* utilize the provisions of the Uniform Division of Income for Tax Purposes Act. Adoption of such provisions in one state does not involve adoption in every state a party to the Compact—rather it is a permissive provision on a per state basis. On the other hand, in those states where the Act, rather that the Compact, has been adopted, compliance is mandatory. Under the circumstances taxpayers should at this time familiarize themselves with the more pertinent provisions of the allocation formula in order to accumulate the necessary data for the preparation of future returns and to permit an evaluation of the permissive provisions of the Compact. To this end we will briefly consider the three factors set forth in Article IV of the Compact:

Property Factor

(1) Rented property will be capitalized at eight times the net annual rental.

(2) In determining the annual average value of other business property, the original cost, rather than net book value, should be used. This means, of course, that fully depreciated property still being used in the business will be included in the property factor.

Payroll Factor

Payrolls will be attributed to a particular state under the following set of circumstances:

(1) If the individual's service is performed entirely within the state.

(2) If service is performed within and without the state, but services without the state are incidental.

(3) Some service is performed within the state and the base of operations or control is within the state *or* the base of operations or control is not in any state where the individual renders service, and he resides within the state.

As will be seen from the above, basically the Payroll factor will be the same for uniform division of income purposes at it is for state payroll tax purposes.

Sales Factor

Article IV of the Compact delineates the allocation of sales of other than tangible property and no problem is presented. At present writing, however, some difficulty is presented in the case of sales of tangible property. The primary rule is that sales will be allocated on the basis of destination with two exceptions:

> Sales emanating from facilities located in a particular state will be attributed to that state, rather than the state of destination, in instances where:
> (a) The U. S. Government is the purchaser, or
> (b) The seller is not taxable in the state where the purchaser is located.

Article IV-3 of the Compact indicates that a seller *is* taxable in another state if in that state he is subject to a net income tax, a franchise tax based on the privilege of doing business or measured by net income, a corporate stock tax, or the state has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does. This last category presents difficulty, but in discussions with tax authorities that have already adopted the Uniform Division of Income for Tax Purposes Act, and in the course of research on the subject it would seem that we must refer to Public Law 86-272. In other words, if orders are filled out of a warehouse in State A and are delivered to a purchaser in State B that does not have an income tax, the receipts are allocable to State B provided State B has jurisdiction to tax the seller (e.g., Seller has a research laboratory in State B) and has not exercised that jurisdiction. If, however, the goods are delivered to a state that has an income tax but, by virtue of Public Law 86-272, taxpayer can establish that sufficient nexus is not present to force him to comply with the taxing laws of that state, he is *not* taxable in the state of the purchaser. Such sales are therefore attributed to the State from whence the goods were shipped.

While all of the foregoing is, as indicated at the outset, a very brief resumé of current state tax problems, it is sufficient to alert both taxpayers and accountants to the necessity of keeping abreast of new legislation. It will only be in rare instances that record keeping will not have to be revised in a multistate business operation. Such revisions should be effected promptly to ameliorate the situation.

D.L.B.

Accounting Procedures for Joint Venture Operations in the Oil Industry

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tures for each lease or unit which has been printed out by the machine. The monthly billing that is sent to the joint venturer has been prepared by the machine in such a manner that the co-owner can see at a glance what part of the indebtedness represents current billing and what portion is a past-due obligation.

After these billings have been completed, the machine will prepare a statement for management aging the joint owner receivables. It will print out the information needed by management in analyzing the accounts receivable from each of their joint venturers.

From the data processed by the service center, a journal entry is prepared debiting the Joint Owners Receivable for their share of their expenditures for the month and a debit to either Leasehold Cost, Lease and Well Equipment, Intangible Development Costs, or Operating Expense for the operator's share of expenditures and the total of these being a credit to the Joint Venture Clearing Account.

Oil and Gas Sales

As checks are received by the operator, they are restrictively endorsed and forwarded with a two-part deposit slip to the accounting department. The original deposit slip and the checks are deposited daily. The duplicate deposit slip is retained until the bank statement is reconciled. At the end of each month, an entry is made debiting Cash and crediting Oil and Gas Sales Payable for the total amount received.

The accounting department prepares for the service center a monthly production transmittal form on all oil, gas and sulphur sales. Included on this form is the lease number, the production code (oil, gas or sulphur), gross production, compression charges applicable to the lease, production taxes applicable to production, and the net value of production from the lease.

Each royalty and working interest owner is assigned a number which is furnished to the service center along with the owner's division of interest in each lease or unit of production. The service center calculates the amount due each royalty and working interest owner and prepares the checks. The total of these checks is used to make a standard journal entry debiting Oil and Gas Sales Payable and crediting Cash. The operator's portion of the production is handled by a monthly journal entry debiting Oil and Gas Sales Payable and crediting Oil and Gas Income.

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